Office of Chief Counsel
Internal Revenue Service

memorandum

CC:WR:SWD:PNX:TL-N-5190-99
MKLee-Martinez

date: November 16, 1999

to: Chief, Examination Division, Southwest District
Attn: Bendall Gard, Revenue Agent, Tucson

from: District Counsel, Southwest District, Phoenix

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subject: [redacted]
Correction of Incorrect K-1 Amounts

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

The Office of Chief Counsel Field Service Division has commented on our October 21, 1999 advisory memorandum. The Field Service Division wants us to clarify the statements in paragraphs 2 and 5 of our advisory memorandum in which we say that correction of an estimated K-1 amount is not a partnership item covered by the TEFRA provisions. We need to make it clear that even though this type of item has fallen out of the TEFRA provisions it is still a partnership item.

Chief Counsel takes the position that the corrective adjustment of the K-1 amount on the partner's return is a partnership item. It is an "item required to be taken into account for the partnership's taxable year" under I.R.C. § 6231(a)(3) and it is the "partner's share of partnership items". *See* Treas. Reg. § 301.6231(a)(3)-1(a)(1). (Please also see the attached memorandum from Thomas W. Wilson, Jr., National Director, Corporate Examinations).

As we stated in our October 21, 1999 advisory memorandum, correction of an estimated K-1 amount falls out of the TEFRA provisions and can be corrected if the statute of limitations for the partner's return is open under I.R.C. § 6501. Pursuant to I.R.C. § 6222(c), the correction of the K-1 amount on the partner's return, which makes the K-1 amount consistent with the amount shown on the TEFRA partnership return, may be computationally assessed without resorting to a partnership proceeding described under I.R.C. § 6225, unless the taxpayer files a "notice of inconsistent treatment". The "notice of inconsistent treatment" is required by I.R.C. § 6222(b).

Chief Counsel takes the position that I.R.C. § 6501 is the controlling period of limitations for making an assessment, whether of a partnership item or non-partnership item. Therefore, the Service can adjust the partner's K-1 for a computational correction by relying upon the partner's open statute of limitations under I.R.C. § 6501. Again, this position has not been tested in the courts so we ask that you notify our office if your taxpayer challenges whether I.R.C. § 6501 is the controlling statute of limitations.

If you have any questions or need additional advice, please feel free to contact me at (602) 207-8058.

/s/ MARIKAY LEE-MARTINEZ

MARIKAY LEE-MARTINEZ
Special Litigation Assistant

Attachment

cc: Bill Kennedy, Large Case Manager
David W. Otto, District Counsel Phoenix

Office of Chief Counsel
Internal Revenue Service

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CC:WR:SWD:PNX:TL-N-5190-99
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We are responding to your request for an opinion as to whether the Service can adjust [redacted]'s (the taxpayer's) [redacted] Federal income tax return (Form 1120) to reflect the amount of partnership losses shown on a corrected K-1. The District must make the adjustment after the statute of limitations (TEFRA) has run for the partnership.

ISSUE:

Can the Service correct an estimated K-1 amount when the statute of limitations for the taxpayer's corporate income tax return (Form 1120) is open, but the statute of limitations for the partnership return (TEFRA statute) has expired?

CONCLUSION:

Correction of an estimated K-1 amount is not a partnership item covered by the TEFRA statute of limitations. Therefore, as long as the corporate taxpayer's statute of limitations for its Form 1120 is open, the Service can make the adjustment to correct the K-1 amount. If the taxpayer does not agree to the correction, then this issue should be coordinated with District Counsel. This advice applies to situations in which the taxpayer has not filed a notice of inconsistent treatment as described in I.R.C. § 6222(b).

FACTS:

The taxpayer overstated partnership losses on its [redacted] Federal income tax return (Form 1120) because it used loss figures from an estimated K-1. After the taxpayer filed its [redacted] consolidated Form 1120, it received a corrected K-1 from the partnership. The taxpayer extended the statute of limitations for the corporate income tax return (Form 1120), but the Form 872 corporate statute extension did not contain language extending the statute of limitations for flow-through items from partnerships. The partnership return (Form 1065) statute of limitations (TEFRA statute) expired on [redacted].

During the audit, the taxpayer told the auditors that it used an estimated K-1 for calculating the amount of the partnership losses shown on the Form 1120. The taxpayer told the audit team that "an adjustment is required" to reflect the difference between the estimated K-1 figures and the corrected K-1 figures. The Service wishes to make adjustments for a partnership loss and an I.R.C. § 1231 loss in the government's favor in the amounts of $[redacted] and $[redacted], respectively.

LAW AND OPINION:

Chief Counsel strongly believes that correcting an estimated K-1 amount is not a partnership item covered by the TEFRA provisions. If the taxpayer's/partner's statute of limitations covering its income tax return remains open, you can make the correction to adjust the losses to the corrected K-1 amounts even though the TEFRA statute of limitations has expired. However,

Chief Counsel recognizes that taxpayers may have an argument that the disputed K-1 amounts are partnership items governed by the statute of limitations under I.R.C. § 6229.

The advice given above pertains to situations in which the taxpayer has not provided a notice of inconsistent treatment as described in I.R.C. § 6222(b). It is our understanding that [redacted] did not file any notices of inconsistent treatment. If [redacted] did file a notice of inconsistent treatment, then the procedures under I.R.C. § 6225 apply to restrict the Service's ability to make adjustments.

We do not anticipate that taxpayers will file notices of inconsistent treatment when they report an estimated K-1 amount. The taxpayer should correct the estimated K-1 amount through an audit adjustment, as [redacted] is doing, or the taxpayer will file an amended 1120. If you encounter a taxpayer who has filed a notice of inconsistent treatment, you should notify District Counsel so that we can review the issue.

Similarly, if you encounter a taxpayer who claims that an expired TEFRA statute of limitations prevents the Service from making the type of correction described in this memorandum, please notify this office immediately. We will need to work with the auditors to put the Service in a good position to litigate the issue.

Finally, please look at the attached memorandum from Thomas Wilson dated September 9, 1999. That memorandum provides language that you should include in all Forms 872 when extending the statute of limitations for corporate income tax returns (Forms 1120). The additional language will allow the Service to make adjustments for flow-through items from partnerships and to avoid the issue described in this memorandum. The flow-through language is particularly important because the audit team may not identify the flow-through partnership items until late in the audit cycle.

The opinions in this memorandum constitute significant large case advice so please allow ten (10) working days for the Office of Assistant Chief Counsel (Field Service) to comment before taking any action. If you have any questions or need additional advice, please feel free to contact me at (602) 207-8058.

MARIKAY LEE-MARTINEZ
Special Litigation Assistant

cc: Bill Kennedy, Large Case Manager